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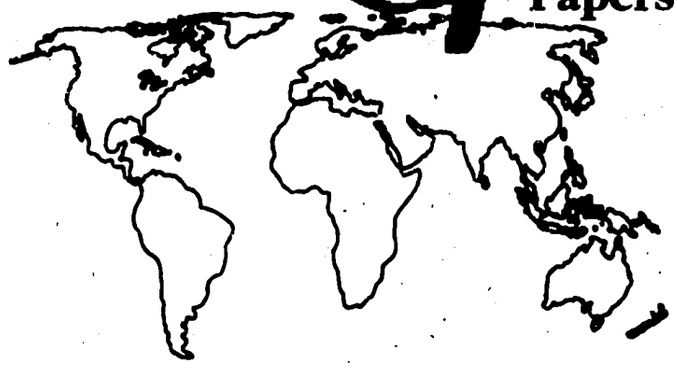

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Reform of the Legal, Regulatory and Judicial Environment - What Importance for Development Strategy?

Clive S. Gray

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HIID

For information contact:
CAER Project Administrator
Harvard Institute for International Development
One Eliot Street
Cambridge, MA 02138, USA
Tel: (617) 495-9776 FAX: (617) 495-0527

REFORM OF THE LEGAL, REGULATORY AND JUDICIAL ENVIRONMENT - WHAT IMPORTANCE FOR DEVELOPMENT STRATEGY?

Clive S. Gray

Harvard Institute for International Development
Cambridge, Massachusetts

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LEGAL, REGULATORY AND JUDICIAL REFORM

1.1 BACKGROUND

During the 1970s it became clear that many poor countries, probably a majority, in pursuing policies that were heavily shaped by ideology, vested interests and/or an overarching concern with equitable distribution of the fruits of development even before there was much fruit to distribute, had built severe imbalances into the structure of their economies. One major manifestation of imbalance was that large spheres of economic activity were reserved to government enterprises that turned out to be riddled with corruption and otherwise incapable of generating significant value added. Another major manifestation was that incentives to export both traditional and new products were dampened in favor of substituting imports to meet demand from a local market that, in large part because of poor export performance, turned out to be sluggish.

To combat these imbalances the international development community urged the countries concerned to undertake programs of 'structural adjustment', and redirected a significant portion of financial assistance to support such programs. Elements common to most of the programs were: pursuit of factor-pricing policies that pointed towards free markets in foreign exchange and capital, thereby **inter alia** raising agricultural producer prices; restraint of government expenditure and bank credit to curb inflation; and reform of the public enterprise sector through introduction of 'hard budget' constraints, contract programs, and privatization.

In 1989 the World Bank and UNDP (IBRD 1989) looked at 31 sub-Saharan African countries regarded as needing structural reform and classified them according to the intensity of their reform programs; 19, or roughly 60 per cent, were judged as having applied 'energetic' programs (Group 1), while the remaining 40 per cent were rated as having 'weak' programs or none at all (Group 2). A comparison of economic indicators (unweighted averages) as between the two groups showed that relative prices were inducing more efficient resource allocation in Group 1, while parameters such as agricultural output, exports, investment and savings performed better in Group 1. On the other hand, during the last period for which comparative data were available, 1985-87, growth of real GDP and per capita consumption performed poorly in both groups and negligibly better in Group 1 than in Group 2 (GDP: 2.8 vs. 2.7%, consumption: -0.4 vs. -0.5%).

The experience of the dynamic export-oriented economies of the Far East warns us not to expect an immediate supply response from "getting the prices right". A realistic exchange rate and other market-oriented policies must be securely in place for a few years before entrepreneurs develop confidence in the government's commitment and are willing to risk their assets. However, whether out of concern that the response has thus far been less than might have been expected, or that remaining obstacles to efficient resource allocation will mute the response when the time comes, the international development community is now looking beyond the policy changes featured in structural adjustment and examining other areas where measures could be taken to accelerate growth. One such area, the subject of this paper, is the legal, regulatory and judicial environment.

Succeeding sections will pinpoint the role of the legal-regulatory-judicial (LRJ) environment in affecting resource allocation and entrepreneurial initiative in poor countries. Phenomena that cause the LRJ environment to impede economic efficiency will be identified, and options for reform will be examined. Attention will focus initially on three pillars of the legal system underlying every market economy, namely security of

private property, enforcement of contracts, and assignment of liability for wrongful damage.

Next, the discussion will consider supplemental categories of business law that facilitate the creation and funding of institutions necessary for efficient production and distribution of many goods and services. It will then review six common fields of business regulation that present options for removing obstacles to efficiency (if only by dismantling the regulatory structure altogether): namely licensing & concessions; regulation of labor, the financial market and prices; control of restrictive business practices; and official conflicts of interest.

Since legislation alone does not define the LRJ environment, the discussion will conclude by examining the functioning of the institutions that determine how the system operates in practice, namely the machinery for settlement of disputes and enforcement of judgments, as well as institutions that affect the transparency of that operation, notably the press.

1.2 THE LEGAL, REGULATORY AND JUDICIAL ENVIRONMENT FOR DEVELOPMENT

The LRJ environment is taken here to comprise the set of rules, institutions and practices governing business transactions. It is a truism that an LRJ system that has evolved within a tribal or feudal society is not adapted to the transactions that characterize a market economy. Most developing countries inherited from their former colonial masters LRJ systems that were consistent, at least in outward appearance, with business transactions characterizing pre-World War II industrial societies.

Again in nominal terms, many of the systems were updated to postwar conditions before independence, and nearly all developing countries have subsequently modernized them, often following quite faithfully recent legislative advances in the former metropole or other industrial democracies. At the same time many of these countries have retained LRJ restrictions over prices, marketing institutions, employment practices, foreign trade, investment and finance that the colonial powers instituted to meet wartime conditions--e.g. the monopsonistic agricultural marketing boards established in British colonies during the war. This has led to the striking peculiarity that most poor countries have a plethora of LRJ mechanisms that protect monopoly, inefficiency and corruption, while mechanisms required for competitive market efficiency are ineffective or absent.

Even when a poor country is endowed with appropriate legislation and institutions it does not automatically follow that implementation proceeds in such a way as to promote the formation of a market economy. The experience of such economies suggests that three additional elements must be present to a greater or lesser degree:

i. A machinery for settlement of disputes in whose integrity and effectiveness economic agents place a minimum level of confidence;
ii. An apparatus for enforcement of judgments under (i) whose integrity and effectiveness likewise enjoy the agents' confidence; and
iii. A minimum degree of consensus among economic agents as to what constitute reasonable rules of the game, and a minimum level of willingness to adhere to the rules;

At first sight it might appear that elements (i) and (ii) would suffice to impose the rule

of law in business transactions, but without the consensus under (iii), the machinery for settling disputes and enforcing judgments would be swamped and thus ineffective. It can be argued that effective institutions under (i) and (ii) are a prerequisite to achieving the required consensus. Without machinery for dispute settlement and enforcement of judgments the incentive to adhere to rules is severely impaired.

The question now arises: what are the principal causes, in poor countries, of:
(a) absence of LRJ rules and mechanisms that favor an efficient market economy,
(b) the plethora of rules and mechanisms unfavorable to competition and efficiency, and
(c) weakness of implementation of 'good' rules and mechanisms?

The first, probably most important answer is linked to the sources of political authority in the Third World. In many countries, notwithstanding the trappings of democracy, individuals and groups hold political authority over extended periods by virtue of (i) their hereditary positions in tribal or clan-directed societies, (ii) their material wealth, starting with but not limited to holdings of land, and/or (iii) their access to means of repression, notably the armed forces and the police.

The meaning of rule of law is that the legal system is sufficiently insulated from the locus of political authority to give persons not sharing in that authority a minimum degree of confidence that their rights under the law will be upheld if they follow its rules. In many poor countries this condition is not fulfilled. A person not sharing political authority cannot be confident that his property will not be confiscated; that his legitimate interest will be upheld if a customer or supplier violates a contract; that he will be able to collect damages from a party responsible for a tort; that he will be subject to (more or less) equal treatment under various types of regulations; or that, other things being equal, he will have equal access to concessions offered by the government to encourage investment, production and employment.

Such circumstances discourage investment by economic agents other than those sharing in the political authority, and restrict the circle of parties with whom they are willing to enter into other than instantaneous transactions. In effect, one is reluctant to conclude contracts with agents other than those with whom one shares kinship or other social ties that facilitate enforcement outside the formal legal system. Clearly such a situation hampers efficient allocation of resources and retards economic growth.

Pari passu with the weakness of human resources that impedes governance at many other levels, implementation of legal systems so as to promote economic efficiency is also obstructed in poor countries by lack of training and experience on the part of the responsible personnel. Some countries seem to be oversupplied with persons skilled at manipulating the law, but others certainly have fewer than they need. Even if the national supply is adequate, the government's weakness often deprives the public sector of its fair share of legal draftsmen, judicial administrators, effective prosecutors, and so on.

Reviewing different areas of law, this paper will examine possible shortcomings in the legislation currently in force in certain poor countries as well as in its implementation, and consider options for reforming these legal systems so as to enhance efficiency and growth.

1.3 THE CONCEPT OF AN OPTIMAL LEGAL SYSTEM

No pretense is made that A.I.D. or any other authority knows enough about the cultural background and constraints of individual countries to write ideal laws and design optimal means of implementing them. From the economic viewpoint, an optimal legal system must satisfy two conditions: (i) for a given set of social benefits generated by the system, it must minimize the sum of transaction costs associated with it; and (ii) the incremental social benefit generated by another measure of regulation would barely offset the additional transaction costs created thereby. Transaction costs are of two types: (1) costs incurred in conducting legal procedures, and (2) inefficiencies that arise in seeking to evade those procedures.

An example of transaction costs is those associated with the licensing of businesses. Some persons desiring to practice a trade decide to seek the required permits, while others decide to pursue the trade without the permits. The first group incurs application and registration fees; legal honoraria; other out-of-pocket expenses; and the opportunity cost of the time spent conducting such procedures and waiting for authorizations. These are transaction costs in the first sense. A member of the second group may have to pay protection money; he may also find it necessary to conduct his trade on a smaller scale and in a more transient manner than he would in the absence of licensing, thereby producing less, incurring higher unit costs and generating lower value added. These are transaction costs in the second sense.

Clearly a legal system does not achieve optimality by reducing transaction costs to zero. Just as society may decide democratically that new drugs should be tested and approved for human use, so also it may decide to zone some urban areas for nonbusiness use, or out of health or safety considerations restrict certain trades to specified areas. (Government may also restrict entry to reduce competition faced by current practitioners, but this is a less reasonable social objective, indeed in most cases a perverse one.) If these restrictions are to be enforced, then some transaction costs are unavoidable. Certain trades will be difficult to close altogether to operators without permits; suppression beyond a certain point would involve administrative costs in excess of the social cost posed by their operation.

An important element of transaction costs is the insurance premia that economic agents pay in order to limit the risk of having to cover damages caused by their actions (in the absence of insurance coverage, the cost becomes the risk of having to cover damages directly). Both damages and, accordingly, premia that suffice to compensate for them are minimized to the extent that (i) agents pay premia in proportion to the probability of causing damages, and (ii) the legal system establishes rules for assessing damages objectively and assigning them fairly to those responsible. Lack of such rules makes costs less predictable, increases risk and poses obstacles to entrepreneurial initiative.

Saying that to each set of social objectives there corresponds an economically optimal LRJ system does not carry us far towards deciding what LRJ system is optimal for a given country. One reason is the variability of social objectives pursued by different governments at different times, and by different social groups, even individuals. Obviously it is not up to A.I.D. or any other outside agent to set social objectives for a sovereign country.

A case in point is ownership of agricultural land. In western industrial societies this is private property, subject to the same LRJ treatment as any other asset class. As will be shown in section 1.4.1 below, some Asian countries with vigorous market economies have pursued social objectives through programs of land reform in which holdings above certain sizes were confiscated at prices well below market. Others, especially in Africa, follow the policy that generalization of fee-simple ownership would prejudice legitimate interests of holders of subsidiary rights without compensating economic benefits.

A second reason for caution in prescribing a unique LRJ system is our lack of knowledge as to which of several alternative approaches to a legal or regulatory issue will yield the most efficient results. What transactions costs would have been incurred in the absence of a particular legal scenario? In what cultures is a comprehensive code more efficient than a common-law approach leaving it to the courts to formulate the law incrementally? What variant of corporation law represents the most efficient model for a particular environment--that of Delaware, New York, or Britain? Should one eschew current western models and look for earlier, less sophisticated variants? What is the interaction between the legal and political systems? Are some models more efficient in a multi-party **versus** a one-party state? In an inflationary **versus** a stable economy? What are the trade-offs between equity and growth? Is growth helped or hindered if small entrepreneurs have the same access to a sluggish judiciary as a captain of industry?

Notwithstanding these uncertainties one can properly take note of the increasing worldwide consensus that competitive market economies, equipped with safety nets for vulnerable members of society, perform far better in satisfying the wants of the masses than other types of economies. Therefore it is appropriate to seek general principles of LRJ reform suited to making competitive market economies function better, while watching out for cultural and other factors that call for variants of the overall strategy.

This will be done in the succeeding sections by first considering three basic elements of a legal system suited to a market economy, namely property, contracts and torts; next examining three further areas of business law, viz. company law, bankruptcy and secured transactions; then turning to six areas of business regulation, i.e. licensing & concessions, labor regulation, financial market regulation, price control, control of restrictive business practices and official conflicts of interest; and finally looking functionally at three categories of implementation, namely dispute settlement, executive enforcement and institutions promoting LRJ transparency.

Before proceeding to the first area of legal substance it is appropriate to acknowledge the intellectual debt owed by this field of analysis to the writings of the Peruvian economist Hernando de Soto, especially in his acclaimed work **The Other Path** (1989). No other writer has yet assembled as much evidence of the obstacles posed to economic activity by a distorted LRJ environment.

1.4 FOUNDATIONS OF A LEGAL SYSTEM FOR A MARKET ECONOMY

As noted by de Soto, property rights, contracts and extra-contractual liability (known by lawyers as 'torts') are the three foundations of a legal system suited to a market economy. The following sections consider briefly the relationship of each of these to development. Implicit in the discussion is not only the substance of the relevant laws but their manner of implementation, that is the extent to which the intent of the laws is realized through the machinery for settlement of disputes and executive enforcement.

1.4.1 Property Rights

In neoclassical economics a system of property rights is economically efficient if the rights are universal (i.e. all property is owned by someone, whether the party is private or public), exclusive and transferable. The theory says that property with no legal owner is

likely to be abused; an owner without exclusivity will incur uneconomically high costs in protecting his claim; while transferability ensures that property accrues to operators capable of realizing the highest value added from it. Property law serves to establish and enforce property rights, settle disputes and assign rights among legitimate uses that are incompatible.

Going beyond these precepts neoclassical economics predicts that private ownership of the means of production will ensure substantially more efficient use of them than state ownership. Little more need be said about this in an era when state ownership has been resoundingly discredited and societies that until recently espoused doctrinaire communism are struggling to create and apportion individual property rights that will generate the incentives needed to revive production.

A dramatic illustration of the returns from facilitating private ownership in a poor country is provided by de Soto's estimate from a sample of 37 informal residential settlements in Lima, that investment in an average house in settlements where occupants were able to obtain land title was worth nine times that in houses whose occupants could not obtain title. This does not mean, of course, that the state may not have a legitimate interest in protecting certain domains from settlement, in which case denial of title can be justified.

Not surprisingly, de Soto finds that a business' ability to defend its rights in property is correlated with its status vis-à-vis licenses or permits required to operate legally. If the business chooses not to acquire or is denied legal status, then its access to the legal system to defend the property it uses in trade against encroachment by the state or private interests is severely limited. No one would argue that such access should be provided to anti-social enterprises, but De Soto's thesis, to which we return in discussing business regulation, is that rent-seeking bureaucrats and/or established businesses seeking a shield against competition have elevated the costs of registration and licensing far above the value of any social benefit generated thereby. Thus, reform in this area would not only enhance the value of much business property owned by small businessmen, along with their incentives to acquire, create and use such property, but it is also desirable on its own merits.

Postwar experience in some poor countries has led many economists to conclude that the neoclassical paradigm of private ownership as a key to efficient use of resources needs to be qualified where concentration of holdings passes certain limits. This applies particularly to ownership of land, and specifically in agricultural areas juxtaposing large individual or corporate holdings with smallholder agriculture and landless rural labor. Some experience--for example, that of Japan, Korea and Taiwan--suggests that state-imposed land redistribution, apart from its merits on grounds of equity, can lead to more intensive use of factors. Taiwan's land reform was conducted with sufficient skill so as to leave displaced landowners with incentives and some wherewithal to spearhead industrialization. This formula has not yet been put to the test in countries such as the Philippines, Morocco and much of Latin America, where landowners retain sufficient political clout to resist land reform.

A different type of qualification emerges from experience in rural Africa, where some administrations, encouraged by donors, have introduced individual land titling with the intention of stimulating agricultural investment through formation of a land market and use of land as collateral for bank credit. Evidence from several provinces of Kenya (Shipton 1989, Atwood 1990) suggests that this effort has often failed to produce the desired results. Traditionally, land is subject to hierarchies of rights and duties that shift as

children grow up and parents age. Individual titling suppresses the interests of subordinate rightsholders both within the family-- particularly female members--and outside it. Irrespective of the effect on resource allocation, the impact on social equity is decidely adverse. In areas where both mixed farming and herding are practised, with land rights subject to seasonal oscillation, interests of the pastoralists likewise tend to fall by the wayside.

At the same time the efficiency benefits of titling are thrown into question by the fact that only a minor fraction of successions and other post-titling transfers are registered. Meanwhile lenders' attempts to foreclose on land posted as collateral and resell it are frustrated by neighbors and kinsmen. Hence the banks remain aloof from smallholder credit.

This experience has encouraged social scientists to reexamine traditional land tenure systems in Africa and reconsider their supposed inefficiency. The current tendency is to stress the security of tenure associated with many systems, the finding that tenure issues are not a major obstacle to innovation, and the fact that, even under traditional systems, much de facto transfer occurs from relatively inefficient cultivators to persons who use more inputs and obtain higher yields. As for credit, this can be secured by chattel mortgages in livestock or machinery, cosignatures by patrons, and group guarantees, as seen in rotating savings and credit associations. A current hypothesis, linked to the discussion of financial market reform below, is that liberalization of that market through legalization of informal credit would increase the supply of credit and lower interest rates to farmers.

In a nutshell, issues of property in agricultural land highlight the tension between theory and observation, leading us to qualify the neoclassical paradigm regarding individual property. In some Asian countries with highly unequal land distribution, imposition of ceilings on holdings has had a beneficial impact on both equity and resource allocation, while in some African countries imposition of individual titling on a complex web of tribal rights and obligations has compromised equity and failed to promote growth.

1.4.2 Contracts

Any exchange of goods or services involves at least implicit contracts. Contract law spells out the terms of implicit contracts, such as undocumented sales, and establishes procedures for implementing the terms of both implicit and written contracts, for settling disputes about implementation, for determining remedies for breach of contract, and in general for meeting contingencies not all of which can be anticipated even in a written contract. Contracts are particularly important for setting the terms of those transactions and relationships which stretch over a period of time.

Economically, contract law is subject to two tests: (1) it should enable parties to match their preferences, and (2) it should maximize predictability, meaning that it produces outcomes that the parties would have specified in their contract had they foreseen the relevant contingencies from the outset. An important condition for passing test No. 2 is that contract law must allocate risk in a fair manner.

De Soto's analysis of the informal sector in Peru illustrates the obstacles faced by a businessman who cannot resort to enforceable legal contracts. His inability to incorporate or form partnerships restricts his access to debt and equity capital, thus limiting the size of his venture and ability to realize economies of scale. The lack of effective guarantees for

performance by unrelated customers and suppliers restricts his willingness to deal outside a circle of close social contacts subject to informal guarantees. Lack of access to enforceable loan contracts restricts the circle of borrowers whom a financier can service. Nonavailability of enforceable rental contracts dampens readiness to invest in rental properties, thus restricting the supply of rental housing--a phenomenon also associated with rent controls (and not only in poor countries).

1.4.3 Torts (Extra-Contractual Liability)

Tort law defines the responsibility of operators vis-à-vis parties with whom they have no contractual relationship. It identifies wrongful damages caused by action and inaction, enacts procedures for assessing their value, and thus lays the basis for insurance to spread risk efficiently, in the process enhancing predictability for business operators.

Tort law is subject to two economic tests: firstly, it should ensure that parties whose interests are wrongfully harmed will receive full, but not excessive, compensation. (Since in practical terms some awards will exceed actual damages while others will underestimate them, the criterion becomes one of ensuring that 'expected' compensation is equal to damages.) Failure of the law and its enforcement to meet this test imposes transaction costs in the form of measures (i) to forestall wrongful damages that might be inflicted by competitors and others, and/or (ii) to compensate for excessive awards. The resulting costs and risks involved may deter operators from production (this is not limited to poor countries--cf. U.S. obstetricians who retire rather than pay insurance premia required to cover recent jury awards).

The second test is that the law should induce operators to take efficient precautions to avoid causing damages. Precautions are efficient when the incremental expected damage they avoid barely offsets their incremental cost. (Absolute precautions are not efficient because they are tantamount to non production). Operators can minimize their risks through liability insurance, at which point insurers assume the burden of ensuring precautions.

The issue arising most often in practice regarding torts is one of implementation rather than legal substance. In many countries small, poorly connected agents have little chance of collecting damages from powerful operators. The intervention of some court systems in transactions of the market economy is either too inefficient or too easily bent in favor of the powerful to give the majority of operators much confidence in that remedy. This may be offset partially by transferring the onus of collecting damages to an insurer capable of defending its own interest. The resulting costs must be reimbursed through relatively high premia (cf. collision auto insurance). For all businesses this increases operating costs; for those not properly registered, insurance is often not accessible.

1.5 SUPPLEMENTAL BUSINESS LAWS

1.5.1 Company Law

The essential function of company law is to limit the liability of shareholders to their shares. Without such protection, equity investors in an enterprise whose assets are exceeded by its liabilities are themselves liable up to the full extent of their assets. Under such conditions few investors would be inclined to help capitalize enterprises over whose

operations they had little control. In the production of many goods and services in a modern market economy, realizing economies of scale requires capitalization far exceeding the means of the entrepreneurs directly involved, their families, and/or partners.

Equity financing achieves its potential within the framework of securities markets, which do not yet play a significant role in most poor countries, though efforts have recently intensified to launch them.

1.5.2 Bankruptcy

The establishment of orderly procedures for transacting an enterprise's cessation is a vital component of business law. Bankruptcy is a normal, even necessary phenomenon in a market economy; its rate varies with the business cycle, but there is an underlying healthy rate for every economy.

Governments of poor countries often try to stifle bankruptcy of not only state-owned but also private enterprises on the ground that it leads to unemployment and wastage of capital. The result, however, is that scarce resources drain into inefficient enterprises, in the process creating unfair competition for efficient ones. Owners of bankrupt enterprises are also prevented from wiping their slate clean and getting a fresh start.

In cases where enterprises cannot be kept afloat, lack of adequate legislation and supervision vitiates orderly establishment of priorities among creditors and opens the de facto liquidation process to fraud. This increases the risk faced by financial institutions, creating costs which they must pass on to borrowers.

1.5.3 Secured Transactions

So as to facilitate investments financed at least in part by credit, creditors must be assured of ability to realize their collateral without delay in the event a borrower defaults on service payments. In some poor countries the law and its implementation are biased in favor of borrowers; there and in many other countries the realization of collateral is a tedious and expensive process. This has the effect of diminishing the creditworthiness of new borrowers and thus hampering investment.

1.6 BUSINESS REGULATION

1.6.1 Licensing & Concessions

In many poor countries issuance of permits to enable enterprises to start up is a tedious process that imposes significant costs on would-be investors without generating a corresponding social benefit. De Soto offers precise data regarding the burden of official authorization procedures on aspiring Peruvian investors. In the case of housing, a group of low-income families desiring to build legally on state wasteland must spend on average 6 years 11 months to obtain the required permits. Adjudication of the land alone requires 207 bureaucratic steps, involving 48 different government offices and taking 3 years 7 months. The process would cost the average family $2,156, equivalent to 4 years 8 months of the minimum wage.

Simulating the opening of a store, de Soto & associates found the required procedures would take 43 days and cost 1 year 3 months equivalent of the minimum wage. Petty traders joining together to build a market would need 8 years to obtain the necessary permits. Obtaining approval for a mini-bus route would take a group of owners 26 months, while 27 months would be required for a single owner to obtain a concession to ply the route.

Taking a sample of 50 informal manufacturers, de Soto et al. found that the direct recurrent cost of keeping abreast of legal procedures would have amounted to nearly 350% of after-tax profit and 11.3% of production costs, 73% of this corresponding to nontax legal costs. Surveying 37 legally established manufacturers, they found that 40% of the administrative staff's working hours were devoted to complying with bureaucratic procedures.

In deciding whether to license new enterprises or expansion of existing ones, some governments take it upon themselves to police entry into particular sectors on commercial grounds and/or second-guess the commercial judgments of entrepreneurs. In 1985 India's Ministry of Industry rejected over 100 investment proposals on one or more of nine different grounds, of which three were (i) the existence of adequate capacity in the sector in question, (ii) the proposal fell short of "minimum economic capacity", and (iii) the feed-stock or raw material required by the project was not available (Gray 1991). Considering that efficiency calls for a constant movement of enterprises into and out of a given sector, it is difficult to reconcile such a licensing policy with efficiency.

Concessions consist of benefits which governments offer to businesses, both foreign and domestic, to induce them to invest, particularly in manufacturing. Typically they focus on exemptions from taxation. Many countries offer duty free import of capital equipment, and/or exemption from profits tax for a fixed period of years; drawbacks of customs duties on imports used to manufacture goods for export is another common feature. This latter benefit may take the form of declaring an enterprise to be a duty-free zone, or agreeing to its inclusion within an industrial estate that enjoys such status. Another common concession involves granting an enterprise access to government-controlled real estate on terms more favorable than are available on the private market. Some investors secure promises of protection against competing imports or against approval of investments by third parties that would compete for the same local market.

More often than not the results of these packages are disappointing, in that they attract less investment than expected. For their part many would-be investors complain about the bureaucratic tangles they encounter in seeking approval of concessions, involving a need to secure clearance from a multiplicity of agencies, engendering lengthy delays and escalation of investment costs, sometimes including payment of bribes. Some countries have witnessed repeated efforts to reform the system, typically through establishment of a superagency with the authority to ensure 'one-stop shopping' for aspiring investors.

As with most types of regulation, legitimate social objectives militate against giving every operator all the concessions he might ask for. Granting investors extraordinary protection against competing imports and investors is in most cases a recipe for economic stagnation. In this vein, the Fiat Motor Company's enlisting Kenya government ministers in helping it in 1976/77 to break the exclusivity previously granted to another motor vehicle assembler was probably an economically positive development, notwithstanding its overtones of corruption.

The decision-making authority should have the competence to decide what concessions

are undesirable and the power to refuse them. At the same time there should be a standard set of concessions whose approval is subject to as little administrative discretion as possible, so as to enhance the transparency and predictability of the system and minimize openings for corruption.

It should be noted that no system of licensing and concessions can or should guarantee commercial viability of an investment, nor protect it against ill-advised macroeconomic policies that bring about inflation and overvaluation of the exchange rate.

1.6.2 Labor Regulation

Most poor countries have detailed labor codes that end up by curbing employment creation in the formal sector. Adopted in response to a combination of pressures from trade unions, politicians seeking support from formal-sector wage-earners, and intellectuals who believe that labor regulation can improve the welfare of the masses, the codes typically include minimum wages, required supplements for overtime or night work, minimum safety and health conditions, vacation periods, participation in the social security system, restrictions on firing (which often requires government approval), severance pay, and procedures for settlement of labor disputes. Minimum wages often differentiate between agriculture and the rest of the economy, and sometimes between geographical areas.

All these provisions increase the cost of hiring labor for those employers, notably the formal sector, who are subject to government supervision. Security from dismissal hampers discipline and reduces workers' incentives to become more productive. Operators respond by substituting capital equipment and other factors of production for labor, and for some operations prefer to hire on a part-time and/or casual basis rather than expand the regular payroll. The stricter the code, the greater the risk that some potential investors will be deterred from any commitment. Strict codes also reduce mobility of labor between firms and industries, limiting the cross-fertilization of skills which is reported to yield positive results in economies such as Taiwan, Hong Kong and Singapore. (On the other hand Japan does very well with labor mobility that is much more limited than in western industrial economies.)

Unrealistic increases in the minimum wage unaccompanied by fiscal and monetary discipline aggravate inflation to the detriment of the development effort. Here again the effect is to restrict employment in the formal sector below what it would otherwise be, involving an obvious social cost.

A system of labor regulation is efficient when the social benefit of the marginal increase in job security and working conditions for formal-sector workers barely offsets the social cost of the marginal reduction in total employment in the formal sector. Beyond this point, greater equity for the minority of a poor country's labor force privileged to work in the formal sector is clearly offset by loss of job opportunities and thus income (and equity) for less fortunate citizens. Political dynamics in some poor countries, where the leadership concedes the demands of organized labor without being aware of the impact on job creation, has carried labor regulation well past this equilibrium.

The same dynamics makes it difficult to rescind any component of a labor code. However, growing appreciation of the benefits of market orientation has made policymakers increasingly aware of the social cost of limiting enterprises' freedom of manoeuver. Senegal in 1988 abolished a requirement that all hiring by formal-sector

employers be conducted through public labor exchanges. The severe fiscal crunch facing most governments has stiffened their bargaining posture in minimum age negotiations. Many governments are in the process of replacing restrictions on job loss resulting from bankruptcy, cessation of operation or reductions in force, with versions of the 'safety net' long characteristic of western industrial economies, notably unemployment compensation, 'golden handshakes', and social welfare benefits in cash and kind. The Eastern European countries are in the forefront of this movement.

1.6.3 Financial Market Regulation

The essence of credit is the exchange of present claims over resources for future claims. Since no one would enter into such an arrangement without some mechanism to enforce future claims, the functioning of a credit market is particularly dependent on the LRJ environment.

Many poor countries have long been accused of engaging in financial 'repression', meaning that controls on deposit and lending rates of interest, resulting in negative real rates, together with sectoral allocation of credit, have constrained the formal financial sector to a relatively limited role. **Inter alia** deposits have been diverted to nonbank institutions offering less security.

Structural adjustment programs have typically called for liberalizing the financial market by freeing interest rates and relying on indirect measures to keep credit expansion in line with prudent monetary policy. Reserve requirements constitute one such measure, though currently less popular than the discount rate and open market operations with government securities.

In some countries the reforms have hampered borrowers' ability and/or willingness to repay loans on time. Higher nominal interest rates have impeded their ability; moreover, where a borrower was once concerned to maintain his creditworthiness with a particular lender in order to secure additional loans at low real rates, it may now be in his interest to delay repayment while borrowing elsewhere at rates equivalent to the market rate demanded by his customary creditor.

Judicial systems in most poor countries are unprepared to deal on a low-cost and timely basis with the enforcement of contracts involving loan repayment. Timeliness is particularly important because the value of collateral may deteriorate as the borrower procrastinates. Anticipating heavy transaction (i.e. foreclosure) costs, lenders may find unprofitable some credit transactions that would otherwise increase efficiency by shifting resources into more productive uses. Hence one facet of desirable LRJ reform is to reduce these transaction costs, while retaining safeguards that protect borrowers from unjustified creditor claims. Costs of foreclosure must be low enough to pose a credible threat, i.e. they must not offset recovery of any part of the outstanding debt.

Some aspects of financial reform presuppose substantial upgrading of the market's LRJ environment via the infrastructure for prudential regulation. Financial liberalization increases competition among lending institutions for both deposits and borrowers and induces them to take greater risks than they did in a 'repressed' environment. The system of government supervision designed to control these risks is not one of the modes of regulation that structural adjustment seeks to abolish or restrict; quite the contrary, notwithstanding the difficulty of the task (cf. the current U.S. savings & loan experience).

Examiners must analyze loan portfolios to look for concealed self-dealing in the form of loans benefitting related parties of an institution's principals; they must also look for nonperforming loans whose status is disguised by refinancing. A recent shakeout in Kenya's financial sector highlighted the low educational status of the central bank's examiners and their lack of incentive to persevere in ferreting out details of their subjects' operations. The result was a series of failures that has certainly lessened the flow of savings into the financial system. In a nutshell, inefficient bank examiners cost an economy much more than do non functioning agricultural extension agents.

In the same connection a country's LRJ system must be prepared to deal with insolvency of financial institutions. This is analogous to the previously cited need for efficient bankruptcy procedures, although in the present case the stakes tend to be higher because of the number of creditors (depositors) involved and the impact of failure of any financial institution on confidence in the sector as a whole. The ideal is a system of insurance for depositors, accompanied by intensive supervision; in its absence, some governments have tended to overreact to insolvencies by drawing on the budget to cover deficits, indemnifying even guilty parties. This has encouraged laxity in both operation and supervision of financial institutions.

Financial regulation in poor countries has traditionally been yet another instance where excessive restrictions on entry coincide with inadequate attention to matters that government ought to regulate. Liberalization has involved reducing these barriers to entry, although few disagree that special licensing (i.e. chartering) procedures are called for in view of the banks' power to create money. As with licensing of other categories of businesses, true promotion of competition requires that this be conducted transparently, based on standard criteria such as capital adequacy and non exceptionable managerial profiles.

Comprehensive reform entails thinking constructively about the role of the informal financial sector, which has traditionally been at best ignored, often subjected to harassment. Informal lenders have recourse to social relationships with borrowers and their families to ensure a high rate of repayment. In some countries they take as collateral post-dated checks, default on which is subject to criminal rather than civil penalties. In the extreme they rely on strong-arm tactics to recover movable assets. The informals depend very little on the formal legal system, even if it does not go so far as to outlaw them.

It has become increasingly clear that this sector alone can service the credit needs of large groups in society. Informals can play a key role in retailing credit which the formal sector provides them in the role of wholesaler. The question arises as to what if any regulation can effectively touch the sector and is desirable to limit abuses. To begin with a revision of the approach of outlawing informal finance is called for since, to the extent it has any effect at all, it only drives the activity underground and increases costs. It makes more sense to recognize the profession, perhaps warn the public about the lack of guarantees for deposits, and provide a legal basis for prosecuting misinformation and other types of fraud.

Finally, poor countries are currently the object of generous technical assistance aimed at helping them develop securities exchanges and associated regulatory bodies. In most countries the main obstacle to development of securities markets is the lack of adequate information about the financial condition of entities wishing to raise funds. The LRJ system must be capable of defining and enforcing requirements to provide reliable and relevant information--including rules to deal with insider trading abuses and other forms of

fraud. Also required is a basic framework for the protection of minority interests.

1.6.4 Price Regulation

The majority of governments of poor countries have at one time or another instituted legislation and machinery to control wholesale and retail prices of so-called 'essential' goods and services. Traditionally such measures have been motivated by a populist concern to protect the masses or selected groups from exploitation by producers and traders. Some governments (and not only in poor countries) have resorted to across-the-board price controls as a measure to control inflation.

Nowadays the consensus based on observation of price control in poor as well as not-so-poor countries is that its results are generally perverse. Its most severe drawback is to curtail supplies, leading to shortages which raise prices for many consumers, often among the poorest, who lack access to regulated distribution channels within which the controlled prices are enforced. Producers and distributors incur evasion costs, thereby raising the cost of distribution. Based on the accumulated evidence, most structural adjustment programs call for reducing controls to limit them to products of public utilities and other so-called 'natural monopolies'.

An AID-funded research program by Moroccan government and university economists examined the impact of price controls and their removal on the business environment in that country. The study found that a substantial share of management energy was devoted to seeking positive action on requests to raise price ceilings in response to cost inflation. Firms tended to regard the ceilings as simultaneously minima and maxima, so that price competition was suppressed, and market shares remained static. Firms invested enough to retain market share but refrained from targeting export markets in the expectation that permitted margins on the home market would not cover the costs of breaking into foreign markets. Finally, the study found that, instead of causing inflation beyond that induced by inescapable cost factors, liberalization introduced an element of dynamism that made the respective markets more competitive and forced producers to become more efficient.

1.6.5 Competition Policy

Competition policy is widely regarded as a logical complement to free trade (and alternative to price control) in holding prices to levels compatible with efficiency. Free trade does a good part of the job vis-à-vis tradeable goods and services, but all industrial countries have found it desirable to take supplemental measures to promote competition in the domestic market.

The LRJ environment as a source of anti-competitive practices. The 'trusts' whose behavior inspired the modern world's first active competition policy in the United States were, of course, private, but in many poor countries today anti-competitive practices are more an outcome of government intervention in the economy than they are of actions by private operators seeking to undermine competition or conspire against consumer interests. Governments award de jure or de facto monopolies to enterprises, public and private; favored enterprises receive overt and hidden subsidies and benefit from rigged government procurement; conversely licenses, concessions, foreign exchange and credit are denied to competitors. Much of this behavior is associated either with outright corruption, that is bribes paid by domestic and/or foreign operators, or with conflict of interest, where

government officials maintain a personal stake in enterprises whose operations are influenced by their regulatory actions. (This phenomenon is treated specifically in the following subsection.)

These practices substantially increase both the costs of doing business and the risks to which enterprises are subject. Management resources are devoted to buying favor with officialdom. Conscious that their financial health depends on the favor of the current government, and aware that many governments lead a precarious existence, enterprises are more cautious about new investments than they would be if they could rely on their own business acumen.

The most important departure in curbing government-directed anti-competitive practices is adoption of the package of reforms identified with structural adjustment, that is substitution of the market mechanism for allocation of resources by government decree. This involves allowing the foreign exchange and interest rates to reach equilibrium levels, so that foreign exchange and credit are no longer allocated by administrative fiat; it involves placing all imports, except those controlled for health and security reasons, under Open General License; and it involves the pursuit of macroeconomic policies that restrain budget deficits and inflation, thus forestalling the pressures that lead governments to reimpose discretionary import and credit controls.

Apart from these measures, regulatory regimes need to be revamped to maximize transparency and minimize official discretion. Laws that regulate licensing of enterprises should be supplemented with written regulations that specify clearly the criteria under which licenses will be granted or denied. The same holds for concessions.

Control of restrictive business practices (RBP). A majority of industrial economies did not follow the U.S. and Canada in enacting legislation against RBP by business operators until after World War II, but all of them now practice RBP control as an essential part of their policy toolkits. The EEC polices RBP in intra-European trade and harmonizes legislation among its members, while the OECD coordinates competition policy among the wider community of western industrial nations.

Conversely, few non-European developing countries have thus far adopted anti-RBP legislation. The current number is around ten, including four in Latin America (Argentina, Brazil, Chile and Colombia), five in Asia (India, Korea, Pakistan, Sri Lanka and Thailand), and so far only one in Africa (Kenya). There is some question as to the appropriate stage in a poor country's development for adopting such a measure. Korea did very well before establishing its Office of Fair Trade in 1981, although it did so then in response to a strongly felt need arising from weakening private initiative, overconcentration of economic power among conglomerates, and unfair trade practices by firms with substantial market power (Gray 1991).

Notwithstanding variations in enforcement, there is a broad consensus among RBP-control authorities in these and the industrial countries as to what practices should be prohibited or restricted. India's Monopolies and Restrictive Trade Practices Commission reflected this consensus in summarizing its cases in 1985 as follows: restrictive zoning of dealers; tied sales; refusal to supply; collusive boycott of a supplier; discriminatory pricing or discounting; exclusive dealing; resale price maintenance; collusive tendering; price fixing; and a single supplier's abuse of market power to manipulate prices (Government of India, 1987).

There is much less consensus, even in industrial countries, as to what constitutes a ceiling on market share beyond which mergers and acquisitions should not be permitted to go. Poor countries justifiably point out that minimum economic scale in many industries is tantamount to a bigger share of a small market than of a large one. Where this is true, free trade that exposes producers to foreign competition is a preferable means of preventing abuse of market power.

In the hands of an administration not dedicated to the spirit of competition policy, RBP control legislation can become simply one more instrument for interfering with business initiative. This is illustrated by a recent experience where the inaugural uses made of a competition policy apparatus were perverse, aimed at frustrating initiatives by businessmen from an ethnic minority. Such moves, even if motivated by concerns of equity for an economically disadvantaged majority, undermine efficiency and retard growth.

One can argue that in this case introduction of an RBP control mechanism was premature. Experience suggests that in a society where arbitrary behavior by the administration is common, it is better not to undertake such regulation unless most decision-making power can be assigned to a judicial or quasi-judicial tribunal staffed by persons in whose integrity the business community will have a certain level of confidence.

It is also important to enact procedures ensuring timeliness and transparency in the tribunal's operations, and to provide for judicial review as to compliance with the law. An RBP control apparatus that interprets normal competitive behavior as unfair practices, discriminates among entrepreneurs according to ethnic origin, upsets mergers and acquisitions not conferring excessive market power, and/or delays its decisions interminably, increases business risk and deters investment.

1.6.6 Control of Official Conflict of Interest

It is becoming increasingly apparent that in some poor countries participation by public officials in business activity for their own account is a serious obstacle to the development of competitive markets. Often the pattern is set by a country's ruler, who appropriates shares for himself and/or family members in new as well as existing enterprises. Sometimes this is done through a holding company with diversified interests in agriculture, manufacturing and/or trade. A decision by an enterprise with such connections to move into a particular sphere sends existing operators in that sphere scurrying for cover. If the enterprise chooses to acquire a certain asset, perhaps a competing enterprise in its entirety, at an 'affordable' price, brave is the owner who declines the offer. Brave also is the RBP control official who blows the whistle on the enterprise's unfair trade practices, or its accumulation of market power.

The ruler's behavior opens the floodgates for everyone else in the government, beginning with cabinet ministers but by no means limited to them. Few poor countries have legislation regulating the phenomenon, which is not addressed by standard rules against corruption, even though an official's involvement may begin with a de facto bribe comprising an offer of shares in return for regulatory favor. A Kenya government commission in the 1970s cited civil servants' potential as a dynamic entrepreneurial force, and urged them to enter business as long as it did not impinge materially on their official duties. The predictable outcome: such activity has not only interfered with performance of administrative functions, but represents a major anti-competitive force in the economy.

In many countries the ruler's example is the first obstacle to controlling conflict of interest. Even were it possible to convince him to set a different example, however, no less an obstacle is the low compensation received by civil servants in many poor countries. Few high-inflation countries have maintained the purchasing power of civil service incomes, notwithstanding ad hoc supplements effected by diverting nonsalary appropriations. Hence, civil servants cannot survive without outside income.

Structural adjustment programs address this issue by limiting new recruitment and sponsoring 'golden handshakes' to encourage redundant staff to leave the service. Improved tax collection relieves part of the fiscal pressure, although simultaneous pressure to reduce deficits by compressing expenditure moves in the opposite direction. In some countries only with accelerated growth and an accompanying expansion of the tax base can one anticipate returning to a pay scale that rewards competent civil servants on the basis of their opportunity cost.

1.7 IMPLEMENTATION

One cannot design a regulatory régime conducive to efficiency and economic growth without considering the institutions charged with implementing it. This section will discuss three categories of institutions for settlement of disputes, namely the judiciary, quasi-judicial regulatory bodies, and private arbitration; enforcement by the executive branch; and vehicles for promoting transparency in the LRJ system.

1.7.1 The Judiciary

In many poor countries a judicial system modelled on that of the colonial power exists side-by-side with a customary court system whose experience is limited to disputes over inheritance, land rights and petty trade, as well as domestic and criminal cases. Even in the system imposed by the colonial power many judges lack a modern legal training, and few have been exposed to the complexities of an industrial economy. Their compensation is such a pittance compared to the interests at stake in modern disputes over property, contracts, bankruptcy, secured transactions, and the fields of regulation described in the preceding section, that widespread corruption is unavoidable.

Weaknesses in existing judicial systems prompt many delegates from poor countries at UNCTAD's annual session on RBP to argue that adjudication of RBP control should be entrusted to the executive branch or to a special commission rather than to the judiciary (UNCTAD, various years). Some countries have sought a way out of the impasse by following the French example in establishing a system of commercial courts whose judges receive special training and enjoy a higher pay scale.

The judicial system is generally neglected as an object of technical assistance aimed at strengthening institutions that promote economic growth. Fortunately it is not the sole vehicle for settling disputes in a market economy, as seen in the following two sub-sections. At the same time nothing can substitute for the judiciary in cases where the parties fail to agree on private arbitration, or as the locus of appeal from auxiliary spheres of dispute settlement. It is in recognition of this fact that a high-level colloquium of Moroccan businessmen has called for "modernization of judicial administration and training of the judiciary to understand the problems posed by the workings of competition" (AIPC-CGEM,

1988).

1.7.2 Quasi-Judicial Tribunals

The United States pioneered in developing quasi-judicial tribunals as a vehicle for economic rulemaking and dispute settlement, especially but not solely between government and private parties, independent of both the executive and judicial branches. Twin objects were to ensure greater impartiality and transparency than might be expected either from an executive dependent on the political process or from an anonymous civil service, while sparing the judiciary from becoming mired down in detailed application of economic policy.

In developing countries quasi-judicial tribunals have made their appearance in the fields of labor disputes (eg. Kenya's Industrial Court), regulation of financial markets (eg. Southeast Asian countries), and RBP (nearly all the ten countries cited in section 1.6.5. have established such bodies). Membership of the tribunals typically represents a variety of professions, including but not limited to magistrates. Tribunals differ in the degree of initiative expected of them; some depend on referral of cases from the executive, others generate cases through their own investigative staffs.

Tribunals also differ in their degree of independence from the executive. Some members serve lengthy fixed terms, while others are subject to removal at the pleasure of the head of government or responsible minister. The latter situation inevitably limits a tribunal's readiness to act in a manner contrary to personal or political interests of the executive.

1.7.3 Private Arbitration

This is a relatively untapped field in the developing world, but one offering a way out of the impasse created by persistent shortcomings in the judicial system. In essence it is an approach towards privatizing justice, which may be no less desirable a component of structural adjustment than is the more widely advocated privatization of state-owned enterprises in response to the public sector's demonstrated incapacity to operate commercial enterprises efficiently. To be sure, it requires a legal framework that enforces awards made under binding arbitration, while punishing corrupt behavior by arbitrators. Judicial review must avoid reopening questions of fact, limiting itself to ensuring fair procedures.

Granting land titles to kinship and other groups as an alternative to individual titling is another approach to privatizing justice, since the group then arbitrates among individual and family claimants. An analogous point is the self-regulation conducted by certain professional groups--e.g.doctors, lawyers, accountants, architects, and quantity surveyors--both in industrial and poor countries. This practice is of course open to abuse, as such groups tend to be partial towards the interests of their own members vis-à-vis the public.

Sectors of the judicial establishment in poor countries oppose private arbitration as impinging on their prerogatives and establishing a class of pseudo-judges, much better paid than their public counterparts and not accountable to society. Perfect competence and impartiality cannot of course be guaranteed, but in a competitive system private arbitrators gain business by earning a reputation for those qualities. Recalling section 1.4.2's definition of economically efficient contract law, an efficient arbitrator makes the award that the parties would have agreed to in the contract had they foreseen the contingencies that led

them to summon him.

A scenario that relies on a sluggish, uneducated and often corrupt judiciary to settle property and contract disputes does not create a business environment conducive to investment, exports and job creation. Hence the premium on testing nontraditional approaches--among them private arbitration.

1.7.4 Executive Enforcement

Court judgments and decrees of regulators and quasi-judicial tribunals are of little effect unless the executive is willing and able to enforce them by seizing property and jailing physical persons or threatening to do so. Two categories of problems arise at this stage: one concerning the resources which the executive can mobilize to enforce the law, and the other concerning its readiness to do so in the face of contrary pressures on behalf of interested parties.

As regards resources, a ministry of justice or attorney-general's office is no less subject than other government agencies to fiscal constraints on staff activity. If budgets do not suffice to hire a minimum staff complement, and/or prosecutors' compensation is less than a living wage, obliging them to moonlight, the agency cannot follow up all its tasks in a timely manner and will likely give priority to actions linked to public safety. Even where the budget is adequate, well-financed commercial interests may secure favorable treatment at any stage of enforcement. (Cases in point are by no means confined to poor countries.) This will more likely be the rule than the exception in cases involving personal interests of officials.

In the context of privatizing justice, one way in which the U.S. itself economizes on prosecutorial manpower is to authorize private suits and provide for multiple damages under antitrust law. By contrast, most countries leave it to government agencies to receive operators' complaints and then decide whether to act.

1.7.5 Instruments of Transparency

In every society officialdom tends towards secrecy in the discharge of regulatory functions, and extra-official institutions are needed to promote the transparency that in turn enhances the integrity, timeliness, and predictability of economic regulation. Foremost among these institutions is the press. In an environment of press freedom, economic journalists like nothing better than to expose corrupt and self-interested actions of officials. Unfortunately such an environment exists in a minority of poor countries. Indeed, barring the occasional exposure of corruption by an official who has had a political falling out with the establishment, the press in poor countries is distinguished by its lack of attention to rampant conflicts of interest.

There is reason to believe that freedom of the press is much more closely linked to the cause of economic development than has generally been recognized heretofore. Even in situations where the electorate has little say in the choice of leaders, officials are more cautious about misusing the LRJ system to promote personal interests in the face of regular press exposure. Notwithstanding the sensitivity of the issue, given increasing indications of the detrimental impact of conflict of interest on the business environment and on the initiative of the majority of entrepreneurs, it can be argued that donors should be

addressing it in the context of conditionalities for structural adjustment aid.

At the very least donors should push for freedom of economic reporting, and make it understood that sanctions against journalists who expose conflicts of interest will jeopardize aid arrangements. Economic journalism should also be an object of technical assistance, including scholarships for study of economics.

1.8 CONCLUSION

The goal of this paper has been three-fold: (1) to highlight the role of the legal-regulatory-judicial (LRJ) environment in affecting resource allocation and entrepreneurial initiative in poor countries; (2) to identify typical shortcomings that make this role less positive than it might be; and (3) to examine options for reform. It was shown that the rules and institutions comprising the LRJ environment operate on efficiency via such subsidiary criteria as transparency, timeliness, stability, predictability, access, fairness, equity and integrity.

Clearly, appropriate legislation cannot alone create a favorable environment; there must also be machinery for settlement of disputes and enforcement of judgments which enjoy the confidence of economic agents, while only generalized respect for the rules of the game can prevent the machinery from being swamped.

The rules most conducive to efficiency and growth will vary widely from one culture to another, and even within a given country, e.g. as regards rural land rights. However, experience in countries of differing cultural backgrounds that have made substantial economic progress points to several categories of law and regulation where provisions with broadly similar characteristics, if not certifiably prerequisites for growth, have nonetheless had a positive impact.

The legal underpinning of every market economy seems to be a system that guarantees private property rights, enforces contracts, and assigns liability for wrongful damage. Further categories of business law supplement these provisions by facilitating the creation and funding of institutions in whose absence efficient production and distribution of many goods and services are not possible. Such laws limit company shareholders' liability, create orderly procedures for exit, and facilitate credit and investment through secured transactions.

Finally, the paper reviewed six common fields of business regulation, namely licensing & concessions; regulation of labor, the financial market and prices; control of restrictive business practices; and official conflicts of interest. Each field presents options for removing currently widespread obstacles to efficiency, if only by dismantling the regulatory structure
altogether (as in the case of much price regulation).

It turns out that many detrimental effects of the LRJ environment are traceable to its subjugation to the interests of powerful groups in society, including government officials engaging in business for personal account. Improvement of the LRJ environment is thus closely linked to political reform, over which the donor community's influence is limited. Donors may however be able to enhance transparency by promoting freedom of the press.

Inter alia the discussion in this paper shows how much is still unknown about what LRJ environment is most conducive to efficiency and growth in a given country, and what changes in existing environments would be cost-effective. The field suggests itself as a candidate for expanded research.

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